

**REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA**

**THE DEPARTMENT OF CONSERVATION
NEEDS TO MAKE SOME IMPROVEMENTS IN
THE BEVERAGE CONTAINER RECYCLING PROGRAM**

**The Department of Conservation
Needs To Make Some Improvements in
the Beverage Container Recycling Program**

P-966, February 1991

**Office of the Auditor General
California**



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February 21, 1991

P-966

Honorable Robert Campbell, Chairman
Members, Joint Legislative Audit Committee
State Capitol, Room 2163
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the Department of Conservation's administration of the State's beverage container recycling program. The report indicates that the Department of Conservation needs to improve its oversight of some program functions and activities to protect the integrity of the California Beverage Container Recycling Fund and to ensure compliance with state requirements.

Respectfully submitted,

A handwritten signature in cursive script, reading "Kurt R. Sjoberg".

KURT R. SJOBERG
Auditor General (acting)

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Summary

- Results in Brief** The Department of Conservation (department) administers the California Beverage Container Recycling and Litter Reduction Act (act). The act requires the department to ensure that the manufacturers and distributors of beverages and the recyclers and processors of beverage containers comply with the act. During our review, we found the following:
- Eleven distributors in our sample made late redemption payments. One of those has not submitted any reports since April 1990. However, the department is not always aware of distributors who make payments late, and it does not always assess penalties against these distributors.
 - Operators of all six of the certified recycling centers in our sample paid us the refund value for nonredeemable containers. Operators of 213 of the 308 certified recycling centers the department tested also paid the refund value for nonredeemable containers.
 - During the third and fourth quarters of fiscal year 1987-88, the department incorrectly allocated \$6.3 million more than the law authorized for program activities. The department spent approximately \$2.7 million of that money.
 - The department did not obtain the approval of the Department of General Services for four contracts for services related to the recycling program.

We reviewed other elements of the recycling program and found few weaknesses. See page 6 for further information.

Background

The act establishes the State's beverage container recycling program, setting a recycling goal of 80 percent of the beverage containers sold in the State. The department is designated to administer the program. Currently, beverage distributors make payments, known as redemption payments, into the California Beverage Container Recycling Fund (recycling fund) for each container they sell to retailers. Consumers may receive two cents for each container or five cents for each two containers when they redeem the containers through certified recyclers. Certified recyclers are then reimbursed for the refund value from processors of recycled containers, whom the department reimburses from the recycling fund. Since the act became effective in 1986, the department has awarded at least 89 contracts for services related to the recycling program. During fiscal year 1989-90, the department collected about \$230 million in redemption payments from beverage distributors and paid about \$130 million in refunds.

**The
Department
Does Not
Identify
Distributors
Who Make
Payments Late**

Distributors of beverages are required to file reports of beverage container sales and to make payments, known as redemption payments, to the department for each beverage container they sell. Eleven distributors in our sample made payments late, and one of those has not made any payments since April 1990. If distributors pay late, the recycling fund loses interest on the amount of the late payments. To discourage distributors from making payments late, the act authorizes the department to assess penalties for late payments. For example, the department could have assessed penalties of as much as \$214,000 against the 11 distributors who paid late. However, the department does not always assess late penalties.

**Operators of
Some Certified
Recycling
Centers Pay for
Beverage
Containers
That Do Not
Have Refund
Value**

The act prohibits operators of certified recycling centers from paying refunds for beverage containers for which no payments have been made into the fund. Operators of all six certified recycling centers we tested paid refunds for nonredeemable containers. In addition, operators of 213 of the 308 certified recycling centers the department tested also paid refunds for nonredeemable containers. If operators pay refunds for nonredeemable containers and are reimbursed from the recycling fund, the money available in the recycling fund to pay refunds for redeemable containers is unnecessarily reduced.

**The
Department
Allocated More
Money for
Some of Its
Recycling
Programs
Than It Was
Authorized
To Spend**

The act specifies the amounts the department may spend for some expenditures funded out of a specific account within the recycling fund. For the third and fourth quarters of fiscal year 1987-88, the department was to calculate the amount for those expenditures using only the amounts deposited into the account for the previous three months. However, the department based its calculations on an additional amount from the previous period. As a result, the department set aside more than \$6.3 million too much for some of its recycling programs. The department has spent approximately \$2.7 million of this money but has agreed to make appropriate adjustments.

**The
Department
Has Not
Obtained
Approval
for Some
Contracts**

The department did not obtain the required approval of the Department of General Services for four contracts exceeding \$12,500 each in our sample of 22 contracts for services related to the recycling program. These contracts were not contracts for consulting, promotional, and advisory services, which the recycling act exempts from approval by the Department of General Services. Contracts requiring this approval are void unless approved.

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| Recommendations | <p>The Department of Conservation should take the following actions:</p> <ul style="list-style-type: none"> • Implement a policy for the rate at which it will assess penalties on late payments; • Direct the service contractor to calculate the penalties due and bill distributors; • Direct auditors to test for late payments during audits of distributors; • Issue inspection regulations for certified recycling centers; • Cease spending funds incorrectly set aside during fiscal year 1987-88, and reduce the amounts it currently has set aside for some of its programs; and • Obtain approval of the Department of General Services for all contracts over \$12,500 for services except consulting, promotional, and advisory services necessary to implement the act. |
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|------------------------|--|
| Agency Comments | <p>The Resources Agency concurs with the findings in our report. The Department of Conservation (department) states that it has implemented a system to automatically identify and create invoices on all missed payments from distributors and that inspection regulations for recycling centers will be adopted in March 1991. The department also states that it is preparing recommendations to the Legislature to clarify spending authority for unspent funds remaining in the redemption account. Finally, the department states that the scope of the exemption of some contracts from the requirements for approval by the Department of General Services appears to be in question but that the department will work more closely with the Department of General Services to determine which contracts require approval.</p> |
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Introduction

The California Beverage Container Recycling and Litter Reduction Act (act) establishes the State's recycling program and designates the Department of Conservation (department) to administer the act. The Legislature intended the act to encourage recycling through convenient, economical, and efficient opportunities for returning beverage containers for the refund established by the act. The act sets a recycling goal of 80 percent for beverage containers sold in the State and specifies that all beverage containers redeemed should be recycled. The Legislature believes that the act will significantly reduce the percentage of beverage containers in the State's litter.

The act requires the department to report the following information annually to the Legislature and the governor: an analysis of the progress made during the previous year toward meeting the recycling goal of 80 percent established in the act; recommendations for containers the department believes should be included in the recycling program; the status of opportunities for recycling beverage containers throughout the State and recommendations for ways to enhance those opportunities; an analysis of the total funds used for program administration and for payment to recyclers; and an analysis of how funds for litter abatement and recycling education are distributed and used. The act also requires the department to report every six months the rates at which beverage containers are redeemed and recycled.

The act requires distributors of beer, carbonated mineral and soda water, carbonated soft drinks, and wine and distilled spirit coolers to deposit a minimum redemption payment into the

California Beverage Container Recycling Fund (recycling fund). This payment, made through the department, is two cents, less one half of one percent for administrative costs, for each aluminum, glass, or plastic beverage container distributors sell to retail dealers in the State. The act also establishes a refund value of two cents for each single container and five cents for every two containers.¹ The act requires that all beverage containers for which distributors make redemption payments bear labels indicating that they have a refund value.

Consumers who return beverage containers covered by the act to recycling centers will receive the refund value established by the act for those containers. Consumers also have other opportunities to recycle containers, such as through programs that provide places for consumers to donate beverage containers and programs that collect containers from residences. Processors of recycled beverage containers purchase redeemed containers from certified recyclers and pay recyclers the refund value. Processors then bill the department for the refund value of the containers and receive payments from the recycling fund. Finally, manufacturers of beverage containers purchase redeemed containers from processors for the scrap value of the containers and manufacture new beverage containers.

The act initially provided that processors and recyclers could receive an amount, known as a redemption bonus, in addition to the refund to encourage more recycling. Legislation that became effective in October 1989 eliminated the redemption bonus program as of January 1, 1990.

The department authorizes certified recyclers and processors to pay and receive refunds for beverage containers through its certification process. The department reports that there are

¹ Containers of 24 fluid ounces or more are considered two containers for purposes of redemption payments and refunds.

about 2,100 certified recyclers and 96 certified processors in the State. The department also reports that about 500 of the certified recyclers consist of machines that accept containers and pay refunds automatically.

Each recycler and processor must be certified to pay the refund value for containers and is prohibited from paying or receiving refunds for any nonredeemable containers. Certified recycling locations that consist of machines cannot discriminate between redeemable and nonredeemable containers, but the department permits reimbursement to their operators only for containers that have refund value.

The department audits and investigates the records and reports of beverage manufacturers, distributors, recyclers, and processors to ensure that they comply with requirements of the act. Since the recycling program began in October 1987, department staff have completed 140 audits and 139 investigations.

In addition to audits and investigations, the department inspects the operations of recyclers to ensure that they comply with program requirements, such as posting their hours of operation and ensuring that they do not pay refunds for beverage containers for which distributors have not made redemption payments. The department also inspects processors to ensure that they make refund payments to recyclers promptly, and it inspects dealers to ensure that they have posted signs identifying the location of the nearest certified recycling center. It also inspects dealers to ensure that they do not sell beverages covered under the act in nonredeemable containers. The department has reported that, during fiscal year 1989-90, staff performed 14,192 inspections including 4,115 inspections of recyclers, 58 inspections of processors, and 10,019 inspections of dealers.

The act provides for expenditures from the recycling fund for recycling-related programs and activities. From the 1986 inception of the act through September 30, 1990, the department entered into 300 contracts and grants totaling \$51.8 million. These

included 211 contracts and grants with community conservation corps and public and private entities for recycling programs and activities. The department also awarded 89 contracts for consulting, promotional, and advisory services as well as for services such as court reporting, claim processing, and auditing.

Department accounting records indicate that, for fiscal year 1989-90, total revenues for the recycling program were about \$232 million, including redemption payments from distributors of about \$230 million. The department also received over \$2 million in interest and about \$240,000 in fines and penalties from participants in the recycling program who violated program requirements. Expenditures for the fiscal year included about \$130 million in refunds for containers and \$15.7 million in administrative costs for the department, recyclers, and processors. See the appendix for an explanation of these administrative costs.

During fiscal year 1989-90, the department deposited about \$87 million of its revenues into the recycling fund's redemption account, from which it made an estimated \$42.2 million in expenditures for program objectives such as incentive payments to recycling centers to maintain convenient recycling locations and advertising, promotion, and litter abatement programs.

Scope and Methodology

To determine whether the department is fulfilling its responsibilities under the act, we reviewed laws, regulations, and policies relating to the recycling program. We reviewed reports the department has issued and documents in the department's files, and we interviewed department officials and officials of participants in the recycling program.

To determine whether the department ensures that distributors file required reports and make redemption payments when they are due, we reviewed reports, prepared by the department's service contractor, of redemption payments made from July 1, 1989, through April 30, 1990. We selected a random sample of 109 of the 436 distributors listed as participating in the recycling program

during that period. For each distributor, we verified whether they made payments for each month or filed reports indicating that they sold no beverage containers. We judgmentally selected 18 of those distributors and reviewed monthly reports they submitted to determine whether they submitted reports by the due date established in the act. Finally, we calculated the penalties the department could have assessed if it had assessed the maximum amount permitted by the act for late payments.

To determine whether operators of certified recycling centers pay the refund value for nonredeemable beverage containers, we selected a random sample of six recycling centers from among the 545 certified recycling centers in Los Angeles and San Francisco counties. We visited the recycling centers and attempted to redeem bags of 104 nonredeemable aluminum cans at each recycling center. We also reviewed the results of a test the department performed to determine whether operators of certified recycling centers pay refunds for nonredeemable beverage containers.

To determine how the department calculated the amounts it allocated for recycling purposes specified under the act, we reviewed department accounting and budgeting records, and we interviewed department staff. We calculated how much money the department allocated for recycling program activities during the third and fourth quarters of 1987-88, and we calculated how much of that amount the department spent.

To determine whether the department complies with state requirements for administering contracts, we reviewed the department's contract files. We selected 25 contracts from among the 255 contracts that had not been approved by the Department of General Services. We submitted these contracts to the Legislative Counsel and asked whether they were the types of contracts requiring approval by the Department of General Services. We also selected a random sample of 22 contracts from among 89 contracts for services the department has awarded since 1986. We reviewed those contracts to determine whether they are of the type that the Department of General Services must

approve. Six contracts in our sample of 22 contracts were included among the contracts we asked the Legislative Counsel to review.

To determine whether the department provided an analysis of the total costs of administering the recycling program, we reviewed the department's 1988-89 annual report. We calculated the department's administrative costs and the administrative costs paid to recyclers and processors from the department's accounting records. We also calculated the amount of administrative costs distributors kept from their redemption payments. We calculated these costs from the numbers of beverage containers distributors sold during fiscal years 1988-89 and 1989-90 as reported in the department's biannual reports and by estimating the numbers sold for program years 1988-89 and 1989-90.

We also reviewed the department's administration of other areas of the recycling program to determine if weaknesses exist. We reviewed the department's process for certifying recycling centers and processors and found that the department certifies recyclers and processors promptly.

We reviewed the department's processes for auditing, investigating, and inspecting participants in the recycling program and found few weaknesses. However, as we point out in Chapter 1, during audits of distributors, department staff do not routinely review distributors' reports of beverage container sales and, thus, cannot ensure that distributors report and make redemption payments when they are due.

We reviewed the department's oversight of its service contractor and found few weaknesses. We also found few weaknesses in the department's process for preparing and reporting data required by the act.

Chapter 1 The Department of Conservation Does Not Identify Distributors Who Make Payments Late

Chapter Summary

Distributors of beverages are required to report their sales of beverage containers and make payments, known as redemption payments, to the Department of Conservation (department) for each beverage container they sell. Eleven of the 109 distributors in our sample made redemption payments late. Moreover, one of the 11 distributors has filed no reports and made no payments since paying late for containers sold in October 1989. When distributors pay late, the recycling fund loses interest on the amount of the late payments. Furthermore, if the department allows distributors to delay making payments, the department risks losing the amounts due if the distributors are unable to pay.

To discourage distributors from making redemption payments late, the department may assess penalties against those who pay late. For example, the department could have assessed penalties of at least \$214,000 for the 11 distributors in our sample who paid late. However, the department does not always assess late penalties.

Background

The California Beverage Container Recycling and Litter Reduction Act (act) requires all distributors who sell beer and other malt beverages, carbonated mineral and soda water, carbonated soft drinks, and wine and distilled spirit coolers to retail dealers in the State to make redemption payments to the department. The department deposits these payments in the California Beverage Container Recycling Fund (recycling fund). Specifically, distributors must report monthly the number of beverages they sell in aluminum,

plastic, glass, and other metal beverage containers and make redemption payments of two cents for each container they sell, less one half of one percent for the distributor's administrative costs. The act also authorizes the department to prescribe the terms and conditions for making redemption payments, such as the dates when reports and payments are due.

In its instructions to distributors, the department specifies that reports of sales and redemption payments are due on or before the first day of the second month following the month distributors made sales of beverage containers. Distributors are to mail these reports and payments to the service contractor who operates the department's Payment and Reporting Processing System (payment system).

**Some
Distributors
Have Made
Redemption
Payments Late**

In May 1990, the department's service contractor reported to the department that, from July 1, 1989, through April 30, 1990, 436 distributors sold beverage containers covered by the act to dealers in the State. In our sample of 109 of those distributors, we found that 11 had made a total of 30 monthly payments from one to three months after they were due. For example, one distributor who owed a redemption payment of more than \$370,000 for sales made during September 1989 made that payment in February 1990, more than three months after the due date.

We also found that, as of November 1990, one of the 11 distributors had not made any payments or submitted any reports of sales activity since paying in April 1990 for containers sold during October 1989. In November 1990, the general manager of that distributor notified the department that the distributor owed over \$172,000 in redemption payments to the recycling fund.

When distributors pay late, the recycling fund loses the interest that it could have earned on the amounts those distributors paid late. Furthermore, if the department allows a distributor to delay paying the amounts it owes, these liabilities will increase as each month passes and the distributor continues to sell products in

redeemable containers. If the distributor has not made payments because of serious financial difficulties, the distributor may be unable to pay the full past due amount, or the distributor may have difficulty remaining in business.

For example, in a letter to the department in November 1990, the general manager of the distributor that has made no payments since April 1990 acknowledged that, as of November 1990, his company owes redemption payments of over \$172,000 and wants to resolve the matter promptly. He proposed a schedule of payments that he hoped would be acceptable to the department without having a serious effect on the company's financial state. The manager of the department's audits branch has notified the distributor that the proposed schedule of payments is acceptable, and the department will assess penalties and interest on the amount due after the distributor makes the last payment.

**Penalties
Not Always
Assessed for
Late Payments**

To discourage distributors from making redemption payments late, the act authorizes the department to assess penalties against distributors who do not make redemption payments when they are due. In its instructions to distributors, the department informs them that they may be subject to penalties of up to 15 percent of the amount due for payments up to a month late and additional penalties of 5 percent for each month the payments remain unpaid.

Although the department has the authority to assess penalties against distributors who pay late, it does not always assess these penalties. For 11 of the 109 distributors in our sample, the department could have assessed penalties of up to \$214,000 for the redemption payments the distributors made late.

The department does not always assess penalties against distributors who pay late, in part, because it has not directed its service contractor to calculate penalties for late payments and to bill distributors for late payments and penalties.

In addition to other responsibilities, the department's service contractor receives and processes reports and records cash receipts from beverage distributors. It also records the receipt of payments and provides the department with accounting reports.

Since the recycling program began, the department has contracted with two different service contractors. It awarded the initial contract for operating the payment system to its first contractor for the period from June 12, 1987, through June 30, 1989. That contract required the contractor to develop a system to report on the promptness of distributors' payments and to develop specifications for a system for processing penalties. Additionally, the contractor was required to create invoices to bill for penalty amounts and to generate daily reports for the department that summarize all missed payments and payments with discrepancies such as erroneous payment amounts. However, the contract did not require the contractor to calculate the amount of penalties for late payments or to send bills to distributors for the penalty amounts.

The department awarded another contract to the same contractor for the period from May 1, 1989, through June 30, 1990. That contract required the contractor to determine whether all distributors have reported each month. The chief of the department's Division of Recycling stated that the department did not supply the contractor with a valid list of all distributors who should be making redemption payments so that the contractor could determine whether all distributors reported.

The contract also required the contractor to create invoices for billing distributors for late payments and penalties and to design a mechanism to send bills for late payments and penalty amounts. The contract specified that the mechanism for billing distributors would be ready for system testing by September 30, 1989. However, the contractor never finished testing the billing system because it was installing a new computer system. In a letter to the contractor, the manager of the department's contract with the service contractor said that he understood that testing the mechanism to send bills for late payments and penalties was postponed primarily because it would be easier to install the mechanism in the new system.

In June 1990, the department awarded the current contractor the service contract for operating the payment system. This contract requires the contractor to account for all redemption payments from distributors and to identify distributors who miss payments. It also requires the contractor to notify distributors if reports and payments are not received and to send bills to distributors for late payments and penalties.

According to the chief of the department's Division of Recycling, on February 1, 1991, the contractor implemented the system to identify distributors who have not made payments by the due date, to calculate the penalty due on overdue payments, to notify the department that payments are late, and to send bills to those distributors.

**Audits
Have Failed
To Identify
Some Late
Payments**

The manager of the department's audit branch told us that, because the department had not implemented the system to calculate penalties for late payments and to bill distributors for the amounts due, the department relied on its audit process to identify late payments. We reviewed the audit process and found that the department's audit staff do not always identify late payments from distributors.

Since October 1987 when the State's recycling program began, the department has completed 91 audits of beverage distributors. The department's files of 17 of those audits contain copies of distributors' reports of beverage container sales. Although these reports show that the 17 distributors made one or more payments late, the department's auditors reported that only 7 of those distributors made late payments.

The chief of the department's recycling division told us that audit staff are instructed to follow a written policy to review distributor reports for late payments. Our review of that policy indicates that, while it prescribes procedures auditors are to use to assess penalties for late payments, it does not clearly direct

auditors to review reports and payments to determine if they were late. For the 17 audits we reviewed, none contained specific steps in the audit program indicating that auditors performed tests of data to determine if the distributors made payments late. Furthermore, the department's internal audit manual, which outlines procedures for auditing distributors, does not require auditors to review monthly reports and payments to ensure they were made on time.

Conclusion During the period from July 1, 1989, through April 30, 1990, 11 of the 109 distributors in our sample made late redemption payments to the Department of Conservation. Moreover, one of those distributors has not made any payments since paying late for beverage containers sold during October 1989. The department could have assessed as much as \$214,000 in penalties against the distributors who paid late. However, the department had not assessed penalties against those distributors because it had not directed its service contractor to calculate the penalties due and to bill distributors for the amounts overdue and for penalties. When distributors make redemption payments late, the California Beverage Container Recycling Fund loses interest on the amount of the late payments. Furthermore, if the department does not assess penalties against distributors for making late payments, distributors may not have an incentive to pay when payments are due.

Recommendations To ensure that distributors are not making late redemption payments, the Department of Conservation should direct its service contractor to implement a system to detect payments that are not made when they are due.

To ensure that the service contractor calculates penalties for late redemption payments and bills distributors for penalty amounts, the department should take the following steps:

- Implement a policy specifying the rate at which the department will assess penalty amounts for late payments and specifying how late the payments must be before the penalty applies; and
- Direct the service contractor to calculate the penalties due from distributors if they do not make redemption payments by the date they are due, and bill them for penalties.

To ensure that auditors identify all late payments, the department should add steps to its internal audit manual specifying that auditors should review reports from distributors to ensure that they made all payments on time.

The department should direct all auditors to calculate penalties due for late payments and ensure that bills for all late payments and penalties are sent to the distributors.

The department should calculate the amounts due from the distributor who has not made a payment since April 1990 and ensure that the distributor pays the amounts due according to the agreed-upon schedule. The department should also assess penalties against that distributor for late payments.

Chapter 2 Operators of Some Certified Recycling Centers Pay for Beverage Containers That Do Not Have Refund Value

Chapter Summary

The California Beverage Container Recycling and Litter Reduction Act (act) established a refund value for beverage containers and prohibits operators of certified recycling centers from paying refunds for beverage containers for which no redemption payments have been made into the California Beverage Container Recycling Fund (recycling fund). However, the operators of all six certified recycling centers in our sample paid refunds for nonredeemable containers. Furthermore, operators of 213 of the 308 certified recycling centers the department tested paid refunds for nonredeemable beverage containers to staff of the Department of Conservation (department). If operators of recycling centers pay refunds for nonredeemable beverage containers and are reimbursed from the recycling fund, the amount available in the recycling fund to pay refunds for redeemable beverage containers is unnecessarily reduced.

Background

The act specifies that only operators of recycling centers that have been certified by the department may pay consumers refunds for beverage containers. Operators of recycling centers and processors of recycled beverage containers are prohibited from paying or receiving refunds for nonredeemable containers. For example, operators of recycling centers may not pay refunds for containers that come into California from outside the State and do not have the appropriate label indicating that they are redeemable for a refund. This does not prohibit operators from paying for the scrap value of these containers, which helps reduce the percentage of containers in the State's litter.

To be certified, operators of recycling centers must demonstrate to the department that they will operate in accordance with the provisions of the act. After giving operators notice and an opportunity for a hearing, the department may revoke, suspend, or refuse to renew the certificates of operators who willfully violate the provisions of the act or any regulations adopted pursuant to the act.

As a condition of certification, operators of recycling centers must provide the department with a plan of operation for each recycling center. The plan must include a description of the method the operator will use to prevent paying refunds for containers that are not redeemable. Operators must notify the department promptly of changes in their operations that conflict with the information submitted in their applications for certification. Staff of the department visit recycling locations and review the operations to ensure that operators comply with the requirements of the recycling program and with the plan of operations they filed with their applications.

**Some
Recyclers
Pay the
Refund Value
for Containers
That Are Not
Redeemable**

To determine whether operators of recycling centers pay a refund for nonredeemable beverage containers, we selected a random sample of four recycling centers in Los Angeles County and two in San Francisco County from among the 545 certified recycling centers the department identified in those counties. At each location, we asked the operators to redeem a bag of 104 aluminum beverage containers that were purchased outside the State of California and that did not bear labels indicating that they had refund value.

In each case, the operators accepted the containers and paid us the refund value for the containers we offered for sale although the operators of each location had posted signs notifying consumers that they would pay a refund only for containers covered under the recycling program.

While the operators of the six recyclers we visited paid us the refund value for the nonredeemable containers, we could not determine whether the processors who purchased those containers from the recycling centers sought reimbursement from the recycling fund. The operators who purchased our containers combined the containers with those from other consumers. The operators then stored the containers at their locations for future shipment to processors.

If operators of recycling centers are reimbursed from the recycling fund for nonredeemable beverage containers, the money available in the recycling fund to pay refunds for redeemable containers is unnecessarily reduced. The manager of the department's inspection section stated after our review of these recycling locations that it is unknown whether the recycling fund is being unnecessarily reduced by the redemption of nonredeemable containers. He also said that, if nonredeemable containers are routinely taken to the six sites we visited, the recycling fund "has suffered by some unknown magnitude."

The extent of the problem is not limited to the recycling locations we tested. The department's plan for enforcement inspections for fiscal year 1990-91 indicates that the department has recognized that operators of recycling centers are paying refunds for nonredeemable containers. According to the plan, during the 1990-91 fiscal year, department staff would inspect 20 percent of the State's recycling centers to test for improper refunds for nonredeemable aluminum cans. The manager of the inspection section said that the goal of the department's test was to ensure that operators use the procedures specified in their certification applications to prevent paying refunds for nonredeemable containers. The manager also indicated that, because of our test, the department accelerated its schedule for testing certified recycling centers. It scheduled its test to begin in September 1990 and completed the test in October 1990.

According to the department's procedures for the test, about 50 percent of the department's sample comprised all the recycling centers within 50 miles of the State's borders; the remainder were

selected randomly throughout the State. The procedures said that sources of nonredeemable containers are known to exist in areas near the State's borders.

In conducting the test, department staff visited 308 of the 1,591 certified recycling centers in the State (machines that accept containers and pay the refund value automatically were excluded). Staff presented nonredeemable containers to the operators for redemption and evaluated the operators' procedures to determine whether they ensure that they do not pay refunds for nonredeemable containers.

The department found that operators of only 86 (28 percent) of the 308 recycling centers refused to pay refunds for the nonredeemable containers. Operators of the remaining 222 (72 percent) did not inspect the containers, and operators of 213 of those recycling centers paid the department's inspectors the refunds. In nine instances, the inspectors stopped the transactions before the operators paid the refunds. In a preliminary report of the department's test of recycling centers, the manager of the inspection section noted that the rate of noncompliance was a surprise and that a different inspection schedule will be used in the future to gain compliance.

**Beverage
Containers
Not Always
Inspected**

After inspecting each recycling location, department staff completed an inspection checklist noting that the operators of the recycling centers either had complied with requirements of the recycling program or had paid refunds for the containers without first inspecting them to determine whether they were redeemable. Both in the test we conducted and in the department's inspection, none of the operators who paid refunds for nonredeemable containers first inspected the containers. For those operators who paid refunds for the nonredeemable containers in the department's inspection, staff noted that the operators either had failed to prevent the payment of the refunds or had changed the methods for preventing payments as specified on their certification applications. For example, the operators of two of the recycling

centers that department staff tested indicated on their certification applications that they would visually inspect containers to prevent redemption of nonredeemable containers. However, department staff noted that those operators had failed to inspect the containers they redeemed during the department's test. The manager of the inspection section said that department staff will reinspect each recycling location that paid refunds for nonredeemable containers.

Operators of recycling centers may not be inspecting containers to ensure that they are covered under the recycling program, in part, because the department has not issued regulations specifying that operators must inspect containers and explaining how those inspections should be performed. Without regulations, the department is not able to enforce inspections by issuing citations for specific violations of inspection requirements.

The department has recently proposed regulations requiring operators to inspect containers to ensure they are covered under the act. The proposed regulations specify that operators of certified recycling centers and processors must inspect each load of containers for which a refund is claimed to determine whether the load is eligible for the refund. The proposed regulations also cite specific inspection techniques operators must use, such as removing the containers from delivery receptacles and monitoring the unloading process. Finally, the proposed regulations specify that operators may not pay a refund under certain conditions, such as when more than 20 percent of the containers in the load are of the type that should be labeled as redeemable but are not and when the motor vehicle of the person delivering the load has license plates from outside the State of California, unless the person meets other requirements in the regulations. The department expects the regulations to be final early in 1991.

Conclusion Although prohibited by the act, some operators of certified recycling centers pay a refund for beverage containers that are not redeemable. Operators of the six recycling centers we tested and 213 of the 308 the department tested paid the refund value for nonredeemable containers. The operators did not inspect the containers to ensure that they paid the refund value only for redeemable containers. If operators of recycling centers are reimbursed from the California Beverage Container Recycling Fund for nonredeemable containers, the recycling fund has less money than it should have for refund values for redeemable containers.

Recommendations To ensure that operators of certified recycling centers do not pay the refund value for beverage containers that are not redeemable, the department should do the following:

- Issue inspection regulations that require operators of certified recycling centers to inspect beverage containers, and specify inspection procedures operators must use; and
- Continue to inspect recycling locations to ensure that operators comply with the inspection regulations.

Chapter 3 The Department of Conservation Allocated More Money for Some of Its Recycling Programs Than It Was Authorized To Spend

Chapter Summary

During fiscal year 1987-88, the California Beverage Container Recycling and Litter Reduction Act (act) provided a formula for determining how much the Department of Conservation (department) was to spend on specified types of programs. However, because the department did not correctly apply the formula, it set aside more than \$6.3 million too much for some of its programs. As of September 30, 1990, the department had spent approximately \$2.7 million of this money, thus exceeding its spending authority by that amount.

Some Program Amounts Calculated Incorrectly

Section 14580 of the act creates the California Beverage Container Recycling Fund (recycling fund) and establishes the redemption account within the recycling fund. Before Section 14580 was amended in October 1989, the redemption account was entitled the "Redemption Bonus Account." Section 14580 also specifies expenditures the department is authorized to make from the recycling fund. These include paying processors the refund value of beverage containers and paying the costs of administering the act. Finally, the section requires the department to deposit into the redemption account all the money remaining in the recycling fund after it has made the expenditures authorized in Section 14580. Section 14581 of the act specifies how the department shall spend the amounts it deposits into the redemption account.

Between September 1986 and September 1988, Section 14581 authorized the department to spend amounts deposited into the redemption account on four different programs. Ten percent of

the amounts deposited for the previous three months was to be spent for contracts with local conservation organizations. An additional 10 percent was to be spent for recycling information, education, or promotion. Section 14581 also permitted the department to spend up to 20 percent for convenience incentive payments. After calculating and deducting the quarterly amounts for these three programs, the department was to spend the remaining amount of the deposits on redemption bonuses. Until legislation eliminated the bonus program as of January 1, 1990, the department was to make redemption bonus payments to processors, in addition to paying redemption value, as an added incentive to encourage recycling.

Section 14580 of the act provided that money in the redemption account was continuously appropriated. This allowed the department to spend the money for the purposes and in the amounts specified in Section 14581 without regard to fiscal year. Thus, the department could set aside money during one fiscal year for an expenditure authorized under Section 14581, but it might not spend the money until a subsequent year. The law did not provide for the money that was set aside in the third and fourth quarters of fiscal year 1987-88 to be spent for any program other than that for which it was originally set aside.

Methodology for Calculating Expenditures

Each quarter, the department calculates the amount to be deposited in the redemption account and determines the amounts it will set aside for the authorized programs. In determining the amounts to set aside for the third and fourth quarters of fiscal year 1987-88, the department based its calculations on the amount deposited in the redemption account during the previous three months plus an amount that had previously been set aside but not spent for redemption bonuses.

The department based its calculations for the third quarter of fiscal year 1987-88 on \$20.8 million. This represents the total of \$12.1 million that had been previously set aside but not spent for redemption bonuses and \$8.7 million that had been deposited in

the redemption account during the previous three months. By using this \$20.8 million to determine the amounts to set aside for the four programs rather than using just the \$8.7 million in redemption account deposits as the law provided, the department set aside more funds for three of the programs than the law authorized to be spent on those programs.

For example, the law required the department to spend 10 percent of the amount deposited into the redemption account for recycling information, education, and promotion. To determine the amount to set aside for these expenditures, the department multiplied 10 percent by the \$20.8 million and set aside \$2.1 million. However, the department should have applied the 10 percent to only the \$8.7 million (the amount that was deposited into the redemption account during the previous three months) and set aside \$.9 million, \$1.2 million less than it set aside. As illustrated in the following table, the department also set aside approximately \$1.2 million more for contracts with local conservation organizations and \$260,000 more for convenience incentive payments than it would have if its calculations had been based exclusively on the previous three months' deposits.

For the fourth quarter of fiscal year 1987-88, the department based its calculations on approximately \$10.1 million that had previously been set aside for redemption bonuses in addition to approximately \$10.9 million that had been deposited into the redemption account during the previous three months. Therefore, the department set aside approximately \$1 million more for contracts with local conservation organizations; \$1 million more for recycling information, education, and promotion; and \$1.6 million more for convenience incentive payments than would have been available had it based its calculations exclusively on the previous three months' deposits into the redemption account.

**Table Amounts Set Aside for Three Programs
During Two Quarters of Fiscal Year 1987-88**

| Program | Amount Set Aside per Quarter | Amount Authorized by Section 14581 | Excess Amount Set Aside | Subtotal by Program |
|---|------------------------------------|--|----------------------------|------------------------|
| Contracts with local conservation organizations | | | | |
| 3rd Quarter | \$2,076,456 | \$ 868,816 | \$1,207,640 | |
| 4th Quarter | 2,097,776 | 1,091,832 | 1,005,944 | \$2,213,584 |
| Recycling information, education, and promotion | | | | |
| 3rd Quarter | 2,076,456 | 868,816 | 1,207,640 | |
| 4th Quarter | 2,097,776 | 1,091,832 | 1,005,944 | 2,213,584 |
| Convenience incentive payments | | | | |
| 3rd Quarter | 2,000,000 | 1,737,632 | 262,368 | |
| 4th Quarter | 3,810,986 | 2,183,664 | 1,627,322 | 1,889,690 |
| Total | | | | \$6,316,858 |

As the table illustrates, during fiscal year 1987-88, the department set aside over \$6.3 million too much for the three programs, including \$2.2 million for contracts with local conservation organizations; \$2.2 million for recycling information, education, and promotion; and \$1.9 million for convenience incentive payments.

**Insufficient
Money for
Redemption
Bonuses**

Our calculations indicate that, for fiscal year 1987-88, the department should have set aside approximately \$23.8 million for redemption bonuses. Instead, because of the methodology it used in calculating the amounts to be spent on the other three programs authorized under Section 14581 of the act, it set aside approximately \$17.5 million for the bonus program. However, this \$6.3 million difference apparently had no effect on the program. According to

the department's accounting records, the department issued redemption bonus payments totaling only \$4.1 million for fiscal year 1987-88.

The chief of the department's Division of Recycling explained that the division did not spend all the funds set aside for redemption bonuses on bonuses because the periodic calculation of bonus payments was based on projections of how many beverage containers would be redeemed. According to the chief, the bonuses that could be paid out in a given period were limited by that formula, and the balance of the redemption account could not always be spent in its entirety.

**No Spending
Authority
for Money
Set Aside
Incorrectly
During Fiscal
Year 1987-88**

Although the department could not spend all funds set aside for redemption bonuses for that purpose, it did not have the authority to use the money for other purposes. The act specified that the money was to be spent on bonuses only. However, as of September 30, 1990, the department had spent approximately \$2.7 million of the \$6.3 million it had set aside during fiscal year 1987-88. Approximately \$470,000 was spent on marketing services contracts, and \$2.2 million was spent on contracts with local conservation organizations and for recycling information, education, and promotion.

As of September 30, 1990, the department had not yet spent the remaining estimated \$3.7 million of the \$6.3 million improperly set aside. This includes \$1,741,669 for recycling information, education, and promotion; \$1,889,690 for convenience incentive payments; and \$27,529 for contracts with local conservation organizations.

We believe the department should reduce the amounts it currently has set aside for these programs, thereby increasing the funds in the redemption account that are not currently set aside for specific programs or expenditures. The department has agreed to make these adjustments.

**Calculation
Methodology
Changed**

Beginning with the first quarter of fiscal year 1988-89 and continuing through the second quarter of fiscal year 1989-90, the department based its quarterly calculations of the amounts to be spent on programs authorized under Section 14581 of the act exclusively upon the amount deposited into the redemption account during the previous three months. We believe this methodology was consistent with statutory requirements then in effect. The chief of the Division of Recycling agrees.

Through legislation that became effective during the second quarter of fiscal year 1989-90, Section 14581 was amended to eliminate the percentage-based calculations that had been required until then. Section 14581 now requires the department to spend \$8 million annually on grants to local conservation organizations and on grants for recycling information, education, and promotion. An additional \$18.5 million may be spent annually on convenience incentive payments. Finally, through June 30, 1990, Section 14581 permitted the department to spend up to \$2 million annually for contracts with recycling centers for advertising and promotion.

Although Section 14581 now specifies exact dollar amounts that the department is authorized to spend on the categories of expenditures funded out of its redemption account, neither Section 14580 nor Section 14581 indicates how or whether the department may spend the money remaining in the redemption account after it has made those expenditures. Department budgeting documents indicate that, as of September 30, 1990, the redemption account balance comprised at least \$61 million in funds not reserved for expenditures currently authorized under Section 14581. Included in this amount is an estimated \$13.7 million that had been set aside for payment of redemption bonuses but had not been paid before the program ended in 1989.

Conclusion During fiscal year 1987-88, the Department of Conservation incorrectly calculated amounts to be spent on several categories of expenditures, setting aside over \$6.3 million too much for contracts with local conservation organizations, convenience incentive payments, and recycling information, education, and promotion. The department did not have the authority to spend the money on other than redemption bonuses. However, as of September 30, 1990, the department had spent approximately \$2.7 million of this money on contracts with local conservation organizations and for recycling information, education, and promotion, thus exceeding its spending authority by that amount. The department has agreed to reduce the amounts it had set aside for programs authorized under Section 14581 of the California Beverage Container Recycling and Litter Reduction Act. This will increase the amount of funds in the redemption account that current law does not authorize the department to spend.

Recommendations To avoid making additional expenditures for which it has no authority, the Department of Conservation should take the following actions:

- Cease spending any funds that were incorrectly set aside in the redemption account during fiscal year 1987-88;
- Reduce the amount the department currently has set aside for contracts with local conservation organizations by \$27,529;
- Reduce the amount the department currently has set aside for recycling information, education, and promotion by \$1,741,669; and
- Reduce the amount the department currently has set aside for convenience incentive payments by \$1,889,690.

The department should make specific recommendations to the Legislature as to how the department should be permitted to spend money in the redemption account that has not been set aside for expenditures authorized under Section 14581.

Chapter 4 The Department of Conservation Has Not Obtained Approval for Some Contracts

Chapter Summary

Since the California Beverage Container Recycling and Litter Reduction Act (act) became effective in 1986, the Department of Conservation (department) has awarded at least 89 contracts for services such as administrative support and technical consulting. However, the department has not always complied with the State's requirements for awarding contracts. The department did not obtain approval from the Department of General Services (DGS) for at least four contracts for services, including the current contract for processing claims and payments submitted by participants of the recycling program. If the department does not receive approval for contracts, the State may face unnecessary risk because the contracts are void.

The Department Did Not Obtain Approval for Some Contracts

Section 10295 of the Public Contract Code specifies that contracts awarded by state agencies for equipment, supplies, materials, and services are void unless the DGS has approved them. Section 1215 of the State Administrative Manual exempts contracts for \$12,500 or less from this requirement.

Section 14530.5 of the Public Resources Code also provides exemptions from the DGS-approval requirement of the Public Contract Code. This section specifies that contracts for consulting, promotional, and advisory services necessary to implement the act are exempt from the requirement for DGS approval. An amendment to this section, which became effective in October 1989, excludes from the exemption those contracts the department awards to certified recycling centers for promotional services.

**Contracts
Requiring
Approval**

To determine whether the department obtained DGS approval for service contracts not subject to the exemption provided in Section 14530.5 of the Public Resources Code, we tested a random sample of 22 of 89 contracts for services the department has awarded since 1986.

Fourteen of the contracts in our sample were for amounts less than \$12,500 and therefore were exempt from approval. In addition, three contracts did not require approval because they were contracts for consulting, promotional, or advisory services, which the Legislative Counsel told us are services exempted by the provisions of Section 14530.5 of the Public Resources Code. According to the Legislative Counsel, one of the three contracts, a contract to provide technical expertise and consulting on recycling issues, may be considered exempt. The other two contracts are for the same types of services, and therefore, we consider them exempt.

The department sought and received approval for one of the remaining five contracts, a contract to provide services for processing reports and payments from recycling program participants from May 1, 1989, through June 30, 1990. However, the department did not seek DGS approval for the remaining four contracts for services not exempted by Section 14530.5 of the Public Resources Code.

One of these contracts is the current contract for \$1.1 million to provide services for processing reports and payments from recycling program participants. According to the Legislative Counsel, this contract may not be considered exempt.

Two of the contracts, each for \$125,000, required approval because they funded contract management services, including monitoring subcontractor progress, scheduling work assignments, providing accounting services for invoice payment, and reporting project status. The Legislative Counsel has said that contracts for these types of services may not be considered exempt. Finally, the Legislative Counsel stated that one contract, a \$399,398 contract to design, produce, and distribute video and audio productions,

may be considered exempt. However, because the department awarded it in August 1987, before the Legislature amended Section 14530.5 of the Public Resources Code to exempt contracts for promotional services from the approval requirements, the department should have sought approval for that contract.

**Requirements
Interpreted
Differently**

The deputy director of the department has stated that the department did not seek DGS approval for service contracts it awards in implementing the recycling act because they are exempt from the approval requirements under Section 14530.5 of the Public Resources Code. Furthermore, a 1990 opinion by the department's legal counsel states that the exemptions contained in Section 14530.5 of the Public Resources Code for consulting, promotional, and advisory services contracts may apply to all contracts for services.

In contrast, the Legislative Counsel states that the exemption does not apply to all contracts for services. According to the Legislative Counsel, because Section 14530.5 of the Public Resources Code specifically exempts contracts only for consulting, promotional, and advisory services, contracts for all other types of services are not exempt from the requirements for DGS approval.

If the department does not seek DGS approval for contracts that require approval, the department prevents the DGS from reviewing the contracts to ensure that they are awarded fairly and are in the best interests of the State. Furthermore, the State may be exposed to litigation between the State and contractors over payment for services rendered by the contractor if the DGS does not approve the contracts.

Conclusion The Department of Conservation has not complied with some of the State's requirements for awarding contracts for the recycling program. The department did not seek the required approval from the Department of General Services for four service contracts worth about \$1.8 million in our sample of 22 contracts. Thus, the State may have been exposed to unnecessary risk because contracts requiring DGS approval are void until approved.

Recommendations To ensure that the Department of Conservation does not award contracts that are void, the department should obtain the approval of the Department of General Services for all contracts for services except consulting, promotional, and advisory services necessary to implement the California Beverage Container Recycling and Litter Reduction Act.

We conducted this review under the authority vested in the auditor general by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,



KURT R. SJOBERG
Auditor General (acting)

Date: February 19, 1991

Staff: Steven L. Schutte, Audit Manager
Anthony F. Majewski
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William Anderson
Cynthia L. Traxler, J.D.
Todd R. Bland
Gregory J. Brown, CPA
Kirk M. Marston

Appendix Administrative Costs of the Recycling Program

The Department of Conservation's (department) costs for administering the recycling program are paid from the California Beverage Container Recycling Fund (recycling fund). These administrative costs include such items as staff salaries and benefits, travel, and equipment and supplies. In addition, the California Beverage Container Recycling and Litter Reduction Act (act) requires distributors to deduct an amount from their redemption payments for their administrative costs. The act also requires the department to pay the administrative costs of processors and recyclers from the recycling fund.

As Table A-1 shows, the total administrative costs for the recycling program during program years 1988-89 and 1989-90 comprise costs for the department, distributors, processors, and recyclers.² The costs for distributors, processors, and recyclers include the costs the department reported paying in its accounting reports and the amounts we calculated distributors kept for their administrative costs. Our calculations were based on the number of containers the department reported sold during the two program years.

²A program year begins on October 1st and ends on September 30th.

**Table A-1 Total Administrative Costs
Program Years 1988-89 and 1989-90**

| | 1988-89 | 1989-90 |
|---|--------------|--------------|
| Department | \$11,409,363 | \$15,555,882 |
| Distributor, processor, and recycler | 2,983,313 | 4,622,775 |
| Total | \$14,392,677 | \$20,178,657 |

Table A-2 shows the administrative costs per container sold by distributors. The department reported that distributors sold 12.8 billion containers in fiscal year 1988-89 and 13.2 billion containers in fiscal year 1989-90. To calculate the administrative costs per container, we divided the expenditures made during each program year by the number of containers sold during each fiscal year.

**Table A-2 Administrative Costs per Container Sold
Program Years 1988-89 and 1989-90**

| | 1988-89 | 1989-90 |
|---|--------------------------|-------------|
| Department | .0891 cents ^a | .1178 cents |
| Distributor, processor, and recycler | .0233 cents | .0350 cents |
| Total | .1124 cents | .1528 cents |

^a The department reported this figure as less than one tenth of one cent per container in its 1988-89 annual report on the California Beverage Container Recycling and Litter Reduction Act.

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California Conservation Corps
Department of Boating and Waterways
Department of Conservation
Department of Fish and Game
Department of Forestry
and Fire Protection
Department of Parks and Recreation
Department of Water Resources

PETE WILSON
GOVERNOR OF
CALIFORNIA



THE RESOURCES AGENCY OF CALIFORNIA
SACRAMENTO, CALIFORNIA

FEB 11 1991

Air Resources Board
California Coastal Commission
California Tahoe Conservancy
California Water Management
Board
Colorado River Board
of California
Energy Resources, Conservation
and Development Commission
San Francisco Bay Conservation
and Development Commission
State Coastal Conservancy
State Lands Commission
State Reclamation Board
State Water Resources Control
Board
Regional Water Quality
Control Boards

Confidential

Mr. Kurt R. Sjoberg
Auditor General (Acting)
Office of the Auditor General
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

Attached are specific comments from the Department of Conservation on your draft report entitled "The Department of Conservation Needs to Make Some Improvements in the Beverage Container Recycling Program."

The Resources Agency has reviewed the draft report and concurs with its findings and the response from the Department.

Thank you for your assistance and opportunity to review the report.

Sincerely,

A handwritten signature in cursive script, reading "Douglas P. Wheeler".
Douglas P. Wheeler
Secretary for Resources

Attachment

DEPARTMENT OF CONSERVATION

DIVISION OF ADMINISTRATION
DIVISION OF MINES AND GEOLOGY
DIVISION OF OIL AND GAS
DIVISION OF RECYCLING



1416 Ninth Street
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February 11, 1991

Mr. Kurt R. Sjoberg
Auditor General (Acting)
Office of the Auditor General
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

Thank you for the opportunity to respond to the Draft Auditor General Report entitled "The Department of Conservation Needs to Make Some Improvements in the Beverage Container Recycling Program."

I want to acknowledge your staff for the professional, objective and thorough way in which it conducted the analyses of the operation and management of our program. We appreciated the opportunity to participate.

Your report acknowledges that in many major areas, Division of Recycling (Division) operations for managing the \$250 million recycling fund were found to have few weaknesses.

Specifically, your report revealed:

- o Recycling centers and processors are certified promptly;
- o There were no material weaknesses in our methods for auditing, investigating and inspecting dealers, processors and recyclers;
- o Division oversight of the service vendor, responsible for preparing and reporting program data, had few weaknesses; and,
- o There were few weaknesses with the Department's method for preparing and reporting, as required by law, recycling rates and other important information to the Legislature.

Mr. Kurt R. Sjoberg
February 11, 1991
Page Two

California's recycling program is unique among state bottle deposit programs because of its reliance on State administration and the emphasis placed on recycling. Other bottle deposit programs emphasize container collection, not recycling, with a narrower goal of litter abatement. Over the past three years the program has been amended by more than 20 separate pieces of legislation, illustrating the high degree of industry and public interest in recycling and the additional need for procedures, processes and staffing to meet the legislative mandates.

The Department believes this report shows that on an overall scale, the \$250 million recycling fund is being managed prudently and that management is following the spirit and letter of the law.

In the process of review, staff from your office worked closely with our staff. As a result, many of the suggestions and recommendations in your report have already been implemented. Additionally, a number of questions raised by your staff during the program review caused the Division to reexamine a variety of its existing procedures. Although these procedures met the legislative requirements, modifications resulting from the review have resulted in additional improvements in administrative areas.

With respect to the four major findings in your report, we have provided detailed comments below:

Section I: The Department of Conservation Does Not Identify Distributors Who Make Payments Late

Response: The Department had also identified this issue prior to your audit, and has been working to correct the problem. As of February 1, 1991, the Department implemented a system that will automatically identify and create invoices on all missed and late payments.

Background and Discussion: The Department feels that the Auditor General's assessment of this issue is fairly representative of past practices as it relates to the Department's ability to oversee our previous service vendor. However, we believe this issue has been successfully resolved. In the beginning stages of the program, priorities were established to concentrate on mandatory aspects and time

deadlines imposed by the California Beverage Container Recycling and Litter Reduction Act (Act). Since the assessment of late and underpayment penalties is permissive in the Act, rather than mandatory, this issue did not receive the same level of priority early in the program that mandatory aspects received.

In 1989, the Department requested the previous service contractor set up a system for identifying delinquent accounts and late payments, but the contractor was unable to accomplish this before the expiration of the contract. Concurrently, in 1989, the Department implemented a standard audit procedure to identify all such missed and late payments during the performance of distributor audits.^①* A request was made of the replacement service contractor to set up a system.

As stated in your report, the Department is committed to implementing an automated system to identify and create invoices on all missed and late payments. This system became operational on February 1, 1991.

Section II: Operators of Some Certified Recycling Centers Pay for Beverage Containers That Do Not Have Refund Value

Response: Inspection regulations designed to curb recycling centers from paying for beverage containers that do not have refund value are slated for adoption by March 15, 1991. In addition, the Division, with help from the State Department of Food and Agriculture and U.S. Customs, has developed a means to identify out-of-state containers presented for refund value.

Background and Discussion: The Department has recognized this issue since the program start-up and has acted vigorously through the regulation promulgating process and through an aggressive investigation program to correct this problem. The Auditor General's report does not take into account that the Department, like the Auditor General, has recognized the need to further clarify inspection practices by recyclers.^② The statute has required inspection but it has taken until 1991 for the Department, working with the industry, to develop enforceable, workable standards for inspection requirements that are practical for the industry and protect the integrity of the recycling fund. Regulations are slated to take effect by March 15, 1991.

* The Office of the Auditor General's comments on specific points in this response appear after the Department of Conservation's response.

In addition to the Department's ongoing active inspection program, the Department has also trained more than 100 food and agricultural inspectors to monitor the flow of beverage containers coming across the borders. Through an interagency agreement with the California Department of Food and Agriculture, inspectors at the State's 16 agricultural border stations review driver manifests, record destinations, and provide other information that will enable the Division to track ineligible payments through its system. The Department also has a relationship with the U.S. Customs Office to exchange information. These efforts to date have been effective in developing a data base to track ineligible containers through its system.

Section III: The Department of Conservation Allocated More for Some of Its Recycling Programs Than It Was Authorized to Spend

Response: Recommended adjustments to the funds set aside for contracts and grants with local conservation organizations, recycling information, education and promotion and convenience incentive payments in the redemption account have been made. The Division has been preparing recommendations to the Legislature to clarify spending authority for the unspent balance remaining in the redemption account.

Because the program was new and there was no other program similar to the Act to serve as a model, there were many unknown factors: the volume of containers that would be recycled and how much money would be left for the administration of the program and for the other program incentives. With these uncertainties, it was also unknown how much money would be available for redemption bonus payments. Therefore the Division did not set a bonus redemption rate for the first two quarters (October 1987 - March 1988) of the program. At the time, we believed our action to be prudent and appropriate.

During the third quarter (April 1988 - June 1988), the Department reviewed our previous practice and revised our procedure. The Division set its first bonus rate and made bonus redemption payments for that quarter and did not carry forward the remaining balances from that quarter on. Thus, the problem was corrected.

The Department is currently initiating recommendations to the Legislature regarding how the Department should be permitted to spend money in the redemption account that has not been set aside for expenditures authorized under Section 14581.

Section IV: The Department of Conservation Has Not Obtained Approval for Some Contracts

Response: The Division was exempted from Department of General Services (DGS) review of certain contracts and from general supervisory powers of DGS. The scope of the exemption appears to be in question, and as a future precaution, the Division will work more closely with DGS to determine which contracts require or do not require DGS approval.

The absence of a DGS review does not mean that the Division failed to apply the same rigorous scrutiny to its contracts. In fact, all applicable laws were followed.

Background and Discussion: The Division's practices regarding the approval of contracts are based on a reasonable interpretation of applicable law. The Act exempts the Division from both the general supervisory powers of the Department of General Services (DGS) and the requirement of the DGS approval of certain contracts. Defining the scope of the Division's exemption from DGS approval requires that somewhat dissimilar terms in the Recycling Act and the Public Contracts Code be harmonized. The Division's interpretation of the two laws was a reasonable one, though different from that of the Auditor General. As an added future precaution, the Division will work more closely with DGS to determine exactly which contracts should be submitted to DGS for approval.

Regardless whether contracts are forwarded to DGS for review, the Division's contracts receive extensive review within the Department of Conservation in accordance with standards set forth in the Public Contracts Code and the State Administrative Manual (SAM). The Division applies the same rigorous scrutiny to its contracts as does DGS. Importantly, all protest matters are processed in accordance with the Public Contracts Code, and are submitted to DGS. Although the Division is technically exempt from the specific contracting requirements in SAM, as a policy matter the Division continues to comply with SAM requirements.

The Auditor General's concern about the validity of contracts such as the \$1.1 million contract to provide services for processing reports and payments from recycling program participants is understandable. However, this particular contract was thoroughly analyzed by DGS during a protest filed by Foundation Systems Inc., an unsuccessful proposer.³ The DGS reviewed extensive arguments

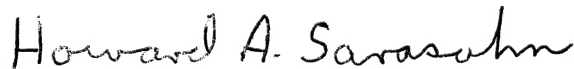
Mr. Kurt R. Sjoberg
February 11, 1991
Page Six

as to the validity of the Division's award of the contract and after a full hearing ruled that the award was proper. Had DGS entertained any doubt as to whether the contract should have been submitted to DGS for approval, this certainly would have been raised during the protest proceeding. ④

In closing, although we do not consider your principal findings to be insignificant, we are pleased that your audit suggests that the Department has done extremely well to get this program up and running, to provide impressive increases in recycling rates, and to sustain the changes imposed by many amendments to the original Act without running into more substantial problems.

Once again, I thank you and your staff for making what could have been a contentious process into an important learning experience, and also one which ratified the public trust placed in the efforts and professionalism of both our staffs.

Sincerely,

A handwritten signature in cursive script that reads "Howard A. Sarasohn".

Howard A. Sarasohn
Deputy Director

RC:HAS:rb

**Comments Office of the Auditor General's Comments on the
Response From the Department of Conservation**

- ① As we point out on pages 11 and 12, the department's procedures for audits of distributors do not clearly direct auditors to review reports and payments to determine if they were late. Furthermore, auditors did not detect late payments during three audits completed after the department implemented the "standard audit procedure" in September 1989.
- ② We state on page 19 that the department has recently proposed regulations requiring operators of certified recycling centers to inspect containers to ensure that they are covered under the act.
- ③ An attorney for the Department of General Services' (DGS) Office of Legal Services states that the DGS does not, as part of any inquiry or investigation associated with a protest hearing, conduct the same type of review upon which DGS approval is predicated.
- ④ The attorney for the DGS also states that when the DGS conducts a hearing to investigate allegations that a contract was not properly awarded, its inquiry is limited to those issues raised in the award protest.

**cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
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